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American Institute of Accountants. Committee on Auditing Procedure

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Statements on Auditing Procedure

No. 19

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Confirmation of Receivables (Positive and Negative Methods)

“**E**XTENSIONS OF AUDITING PROCEDURE,” approved by the membership of the American Institute of Accountants and issued in 1939, contains the following recommendation:

“That hereafter, wherever practicable and reasonable, and where the aggregate amount of notes and accounts receivable represents a significant proportion of the current assets or of the total assets of a concern, confirmation of notes and accounts receivable by direct communication with the debtors shall be regarded as generally accepted auditing procedure in the examination of the accounts of a concern whose financial statements are accompanied by an independent certified public accountant’s report; and that the method, extent, and time of confirming receivables in each engagement, and whether of all receivables or a part thereof, be determined by the independent certified public accountant as in other phases of procedure requiring the exercise of his judgment.”

It will be noted that the *method* of confirming receivables in each engagement is left to the judgment of the independent certified public accountant as in other phases of procedure requiring the exercise of his judgment.

Generally speaking there are two methods of confirming receivables by direct communication with the debtor, known as the “positive” and the “negative” methods. When the “positive” method is used a communication is addressed to the debtor asking him to confirm to the independent public accountant the accuracy or otherwise of the balance shown. When the “negative” method is used a communication is addressed to the debtor asking him to advise the independent public accountant only in cases in which the amount stated is incorrect.

In dealing with confirmation of receivables from the government, the committee stated that “Extensions of Auditing Procedure” “did

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not contemplate that the 'negative' form would be used if the independent public accountant had reason to believe that the request would fail to receive consideration and that he would not be advised if the amount stated in the request differed from the amount shown on the debtor's records."¹ In such circumstances the committee suggested the nature of alternative procedures to be adopted in lieu of direct confirmation with the debtor.

In Bulletin No. 3 the committee stated that, "It is believed, therefore, that department stores, instalment houses, and others dealing with ultimate consumers are among the cases in which the application of the negative form of direct communication with debtors, when carried out in the manner suggested in the bulletin, 'Examination of Financial Statements,' is to be considered as compliance with 'generally accepted auditing procedure.'"²

The foregoing statements by the committee were of limited applicability and it has been suggested that the committee deal with the subject in a more general way. Although the method of confirmation must, in the final analysis, be determined by the independent public accountant in the exercise of his judgment, the committee believes that certain general observations may be helpful.

In cases in which there is reason to believe that the possibility of disputes, inaccuracies or irregularities in the accounts is greater than usual, or where the balance involved is of outstanding materiality, it is probably desirable that the "positive" method of confirmation be adopted. For example, it is generally customary to use the "positive" method of confirmation in the case of receivables of stock brokerage houses. Also, where a company sells a substantial portion of its output to one, or only a few, customers, so that the balances involved are of relatively major importance, the "positive" method of confirmation would seem preferable.

On the other hand, it is the opinion of the committee that the "negative" type of confirmation is in accordance with generally accepted auditing standards and practice in the majority of circumstances, and that an independent public accountant using this method of confirmation, where there are no indications that it may be inadequate, is conforming with generally accepted auditing standards.

Not infrequently independent public accountants employ both the "positive" and the "negative" methods upon the same engagement—the "positive" as to accounts where a definite reply may be

¹"Statements on Auditing Procedure No. 18," page 127.

²"Statements on Auditing Procedure No. 3," page 18.

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deemed desirable and the "negative" as to accounts where this consideration does not apply.

When "positive" confirmations are sought, it is usually impossible to secure responses to all requests; as a matter of fact, even in the case of stock brokerage houses, where the requests are usually followed up more actively than in the ordinary case, it is rare that replies are received to all requests.

Whether the response to "positive" confirmations requested is satisfactory is usually judged by comparing the number of replies received and the aggregate amount thereof with the number and amount of the confirmations requested, taking into account also the nature of the replies and the situation they disclose. The percentage of replies received, experience has shown, varies considerably with the type of customer with whom the organization deals. The independent public accountant must assume the responsibility for deciding whether the nature and the extent of the response, taken in conjunction with his other auditing procedures, constitute a satisfactory basis for his opinion as to the bona fides of the receivables. This is a matter for the exercise of his judgment in the circumstances of the individual case. If he does not consider the confirmation satisfactory he should pursue the matter further, either by communicating again with those who have not replied or by adopting alternative procedures of the nature referred to previously.

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